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IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 11.12.2006

CORAM:

THE HONOURABLE MR.JUSTICE P.D.DINAKARAN
and
THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

T.C. (A) No.20 of 2004

The Commissioner of Income Tax
Central I, Chennai. .. Appellant

Vs

M/s.NEPC India Limited
Chennai-2. .. Respondent

Tax Case appeal filed against the order dated 30.6.2003 made in I.T.A.No.1568/Mds/2000 of the Income Tax Appellate Tribunal Madras "A" Bench for the Assessment year 1993-94 and the order dated 31.7.2000 on the file of the Commissioner of Income tax (Appeals), Chennai -34 in IT/Appeal No. 153/98-99 against PA No. AAACN 1567 E in the order dated 5.2.99 and passed in AA NO. AAA CN1567E of the Deputy Commissioner of Income Tax, Central Circle I(I), Chennai.

For Appellant : Mrs.Pushya Sitaraman
Sr.Standing Counsel (IT)
For Respondent : Mr.R.Sivaraman

JUDGMENT

(Delivered by P.D.DINAKARAN,J.)

This tax case appeal has been preferred raising the following substantial question of law:

"Whether in the facts and circumstances of the case, the Tribunal was right in holding that Section 40A(2) of the Income Tax Act is not applicable merely because the goods in question were sophisticated and specialised components?"

2. Brief facts which are necessary to dispose of the appeal are recapitulated as under:

2.1. The respondent/assessee is a public limited company engaged in the manufacture and sale of wind turbine generators. The relevant

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assessment year is 1993-94. The Assessing Officer, finding that the purchase price of certain items from the sister concern of the assessee is inflated when compared to that quoted by the third parties, disallowed the sum of Rs.3,54,76,323/- on account of such inflation under Section 40(A)(2) of the Income Tax Act (for brevity, "the Act").

2.2. On appeal by the assessee, the Commissioner of Income Tax (Appeals) remanded the matter back to the Assessing Officer with a direction to give the assessee an opportunity to produce evidence in this regard.

2.3. On remand, the Assessing Officer, finding that higher purchase price was adopted by the assessee on the purchase of blades and gear boxes from its sister concern, viz., M/s.Standard Engineering, with a view to reduce its income tax liability, in the light of the decision in McDowell & Co. Ltd. v. C.T.O., [1985] 154 ITR 148 confirmed the disallowance.

2.4. On further appeal by the assessee, the Commissioner of Income Tax (Appeals) held that the price difference as brought out in the order of assessment is not so startlingly large to raise a suspicion that there was an inflation in the purchase price from M/s.Standard Engineering and deleted the additions made.

2.5. On appeal, at the instance of the Revenue, the Tribunal upheld the order of the Commissioner of Income Tax (Appeals). Exasperated, the Revenue has preferred this tax case raising the substantial question of law referred above.

3. Heard both sides.

4. Before proceeding further it is apt to refer Section 40A(2) of the Income Tax Act, which reads as under:

> "Section:40A. Expenses or payments not deductible in certain circumstances.--
> (1) ....
> (2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction:

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Provided that the provisions of this sub-section shall not apply in the case of an assessee being a company in respect of any expenditure to which sub-clause (i) of clause (c) of section 40 applies."

(emphasis supplied)

5. A careful dissection of Section 40A(2)(a) of the Act requires the following ingredients to be satisfied for invoking the power conferred under the said Section, viz.,

i. the assessee should incur an expenditure in respect of which payment has been or is to be paid to any person;
ii. in the Assessing Officer's opinion, such expenditure, should be excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom; and
iii. the expenditure, which is considered by the Assessing Officer to be excessive or unreasonable, shall not be allowed as a deduction.

6. It is true the Constitution Bench of the Apex Court in McDowell & Co. Ltd. v. C.T.O., [1985] 154 ITR 148, in clear terms held that tax planning may be legitimate provided it is within the framework of the law and colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by dubious methods; that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges; that there is behind taxation laws as much moral sanction as is behind any other welfare legislation and it is a pretence to say that avoidance of taxation is not unethical and that it stands on no less a moral plane than honest payment of taxation and therefore, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be construed literally or liberally nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to avoid tax and whether the transaction is such that the judicial process may accord its approval to it. It is neither fair nor desirable to expect the Legislature to intervene and take care of every device and scheme to avoid taxation. It is up to the court to take stock to determine the nature of the new and sophisticated legal devices to avoid tax and to expose the devices for what they really are and to refuse to give judicial benediction. The evil consequences of tax avoidance are manifold, viz.,

i. there is substantial loss of much needed public revenue, particularly in a welfare State like ours;
ii. there is the serious disturbance caused to the economy of

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the country by the piling up of mountains of black money, directly causing inflation;

iii. there is 'the large hidden loss' to the community by some of the best brains in the country being involved in the perpetual war waged between the tax avoider and his expert team of advisers, lawyers and accountants on one side and the tax gatherer and his, perhaps not so skilful, advisers, on the other side;

iv. then again there is the 'sense of injustice and inequality which tax avoidance arouses in the breasts of those who are unwilling or unable to profit by it'; and

v. last, but not the least, is the ethics of transferring the burden of tax liability to the shoulders of the guideless, good citizens from those of the 'artful dodgers'.

7. In the context of the law laid down by the Apex Court in McDowell & Co. Ltd. v. C.T.O., [1985] 154 ITR 148, it is, no doubt, clear that the modern Judge, is the maker of economic and social reforms, apart from interpreting the law and adjudicating disputes.

8. Now, let us analyse the power and jurisdiction conferred on the Assessing Officer under Section 40A(2)(a) of the Act, which revolves on the discretion conferred on him in the context of "Assessing Officer is of opinion". The words "is of opinion" indicate that the opinion must be formed by the Assessing Officer and it is of course, implicit that the opinion must be an honest opinion, having been formed based on the circumstances available before him. In other words, what all, therefore, Section 40A(2)(a) of the Act contemplates is that there should be some material available for the Assessing Officer for invoking Section 40A(2)(a) of the Act to initiate action to disallow or refuse to deduct the excessive or unreasonable expenditure mentioned thereunder. But, at the same time, before taking any final decision by invoking the power under section 40A(2)(a) of the Act, either allowing or disallowing such expenditure incurred as excessive or unreasonable, such decision of the Assessing Officer should be based on reasons well-founded, which are judiciously acceptable and in which event, the finding or decision arrived at stating that the expenditure is excessive or unreasonable and the same cannot be allowed or deducted, certainly would become purely a question of fact, which the Court cannot interfere, in view of the ratio laid down Commissioner of Income Tax v. T.T.Krishnamachary & Co., [2002] 256 ITR 82, whereunder it is held that the finding that the payment was not excessive, as another party has also purchased at increased price, is one of the fact. But, the situation in the case on hand is not on the same footing, as relevant materials to establish that the expenditure incurred by the assessee for purchase of the impugned goods was not excessive and reasonable qua the sales of similar goods made by M/s.Standard Engineering to any third party during the relevant period were neither produced by the assessee

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before any of the authorities below, viz., the Assessing Officer, the Commissioner of Income Tax (Appeals) and the Tribunal, nor before this Court.

9. In the instant case, admittedly, with regard to the purchase of the blades set and gear box, two prices were available before the Assessing Officer, one price quoted by M/s.Standard Engineering, which is concededly a sister concern of the assessee, and another by M/s.Indian Molasses Company, a third party, as stated below:

Item of purchase	Prices per set/unit to		Difference
	Standard Engineering	Indian Molasses Company	
Blades set	15,96,515	12,06,398	3,90,117
Gear Box	13,35,907	10,59,031	2,76,876

The difference, as apparent from the above statistics, is glaring and works out to nearly 25% of the price per set/unit.

10. However an argument is advanced by Mr.Sivaraman, learned counsel for the assessee that the burden is on the Revenue to prove that excessive and unreasonable expenditure has been incurred for the purchase of blades set and gear box by the assessee from its sister concern, when compared to that of M/s.Indian Molasses and the fair market value of the goods in question. According to him, the Revenue having failed to discharge the said burden to collect the fair market value of impugned goods and then compare it with that of the prices offered by the assessee's sister concern, has no authority to invoke Section 40A(2)(a) of the Act and therefore, the very initiation of the proceedings under Section 40A(2)(a) of the Act is without jurisdiction.

11. We are unable to agree with the said contention of Mr.Sivaraman, because what is required is that the opinion of the Assessing Officer, should be formed solely based on the circumstances available before him; and once, based on such material available, as referred to above, viz., the price per set/unit quoted by M/s.Standard Engineering and M/s.Indian Molasses, pursuant to which, the Revenue has called upon the assessee to furnish other materials to discharge the burden, the burden is shifted on the assessee to prove that the expenditure is not excessive and reasonable. It is not in dispute that the Revenue has given such an opportunity to the assessee in the instant case, but the assessee failed to avail the same. The assessee ought to have, in our considered opinion, as in the case of Commissioner of Income Tax v. T.T.Krishnamachary & Co., [2002] 256 ITR 82, furnished the details of sales of similar goods made by

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M/s.Standard Engineering to any third party during the relevant period, assuming it is not possible to arrive at the fair market value of the impugned goods as contended by both the sides. In the same way, nothing prevented the assessing officer to satisfy with the details of the price quoted by M/s.Standard Engineering, for having sold identical goods to another party, who had also purchased it.

12. The assessee having not done anything to prove the above claim is not entitled to now complain that the Revenue has not discharged the burden and such argument advanced by Mr.Sivaraman, is totally misconceived. A similar view is also taken by the Bombay High Court in C.I.T. v. Shatrunjay Diamonds, [2003] 261 ITR 258, wherein it is held that:

> "Once purchases are made by the assessee from the persons falling under the category under Section 40A(2)(b) of the Income Tax Act, 1961, the burden is upon the assessee to establish that the price paid by it is not excessive or unreasonable. In cases falling under Section 40A(2)(b) it is the duty of the assessee to prove and discharge its burden by leading proper evidence subject to cross-examination by the Department."
>
> (emphasis supplied)

13. On the other hand, we are also unable to appreciate the approach adopted by the Appellate Authority or the Tribunal in arriving at the finding that the Assessing Officer had committed an error in disallowing the expenditure incurred by the assessee as excessive and unreasonable without any specific finding on that aspect, except stating that the goods purchased are sophisticated in nature and that the deduction and allowance claimed by the assessee are startlingly large and therefore, suspicious. The said finding arrived at by the Appellate Authority and the Tribunal, in this regard, is, in our considered opinion, not based on any judicious reasons and therefore, the same cannot be accepted as it is well recognised that there is no equity or morality about a tax.

14. After carefully weighing the matter from all perspectives, we are of the considered opinion that it is a fit case to allow the appeal by answering the substantial question of law raised in favour of the Revenue, and remit the matter to the Assessing Officer, with a direction to give an opportunity to the assessee to discharge his burden and satisfy the Revenue that the expenditure incurred by it in connection with purchase of blades and gear boxes from its sister concern, viz., M/s.Standard Engineering is not excessive or unreasonable by producing relevant records from the sister concern as to the sale of similar goods during the relevant period to any third party. The assessee, of course, is also at liberty to raise any other contention as they deem it fit and necessary.

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This tax case is allowed with the above direction. No costs.

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Sd/
Asst. Registrar

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Sub Asst.Registrar

To:

1.The Assistant Registrar,
Income Tax Appellate Tribunal
Madras Bench "A". Chennai.

2.The Commissioner of Income
Tax (Appeals-II), Chennai.

3.The Deputy Commissioner of
Income Tax, Central Circle(1)
Chennai.

4.The Assistant, ITAT,
Rajaji Bhavan, Besant Nagar,
Chennai.

5.The Commissioner of Income Tax,
Central I, Chennai.

1 CC TO MRS. PUSHYA SITARAMAN SR. STANDING COUNSEL FOR I.T SR 61595

1 CC TO MR.R. SIVARAMAN, ADVOCATE SR 61606

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